United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLEE

76-
75-7058

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P/S

United States Court of Appeals

FOR THE SECOND CIRCUIT

No. 75-7058

CY SEYMOUR,

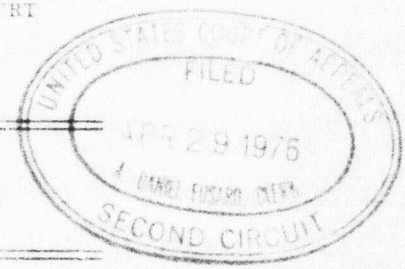
Plaintiff-Appellee,

—against—

BACHE AND COMPANY, INCORPORATED, and ALEX CANAAN,

Defendants-Appellants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK



PLAINTIFF-APPELLEE'S BRIEF

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PRELIMINARY STATEMENT

Plaintiff Cy Seymour ("Seymour") instituted this action against defendant Bache and Company, Incorporated ("Bache") and defendant Alex Canaan ("Canaan") to recover damages caused by the churning of Seymour's securities account.

Bache and Canaan moved to stay the action on the ground that the dispute should be submitted to arbitration pursuant to an arbitration clause in Seymour's margin agreement with Bache. This is an appeal by Bache from the memorandum decision of the United States District Court, Southern District of New York, Charles H. Tenney, J., which was entered on January 14, 1976, denying the defendants' motion to stay the action.[1]

ISSUES PRESENTED

1. Did the District Court err in denying the motion to stay the action when an agreement to arbitrate was entered into after some of the acts complained of occurred?

2. Did the District Court err in denying the motion to stay the action when the complaint alleges violations of the 1934 Securities and Exchange Act[2] but not the 1933 Securities Act?[3]

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[1] Canaan has not appealed the decision of Judge Tenney. Since this is an action at law, the decision of Judge Tenney is appealable. See Shanferoke Coal and Supply Corp. v. Westchester Service Corp., 293 US 449, 55 S.Ct. 313, 79 L.Ed. 583 (1935); American Safety Equipment Corporation v. J.P. Maguire Co., 391 F 2d 821 (2d Circuit 1968).

[2] 15 U.S.C. 78a et. seq. (hereinafter "the 1934 Act").

[3] 15 U.S.C. 77a et. seq. (hereinafter "the 1933 Act").

STATEMENT OF THE CASE

The complaint alleges that Canaan was Seymour's account executive from July 1, 1969 to May 31, 1974.[4] During this time period, Canaan was employed by Bache from July 1, 1969 through April 30, 1972. Canaan was then employed by the brokerage firm of Weis Securities, Inc. from May 1, 1972 through April 30, 1973. Canaan then returned to Bache and was employed by them from May 1, 1973 through May 31, 1974.

On December 5, 1970, Seymour entered into a margin agreement with Bache which contained an arbitration clause. This clause states in pertinent part that:

> This contract shall be governed by the laws of the State of New York...any controversy arising out of or relating to my account, to transactions with or for me or to this agreement or the breach thereof, shall be settled by arbitration in accordance with the rules then obtaining of either the American Arbitration Association or the Board of Governors of the New York Stock Exchange, as I may elect...

When Canaan returned to Bache, Seymour signed another margin agreement on June 4, 1973 which contained the same arbitration clause.

The complaint alleges that Canaan exercised control over Seymour's account and caused an excessive number of transac-

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[4] The allegations of the complaint must be taken as true for purposes of determining whether or not issues are presented which arise under the 1934 Act. Maheu v. Reynolds & Co., 282 FSup. 423, 428 n.1 (SDNY 1967)(on reargument) citing Wilko v. Swan, 346 US 427, 74 S.Ct. 182, 98 L.Ed. 168 (1953).

tions in Seymour's securities account. The complaint also alleges that Bache failed to properly supervise the activities of Canaan. The acts of Canaan and Bache are alleged to be violations of Rule 10b-5 of the 1934 Act.[5]

Bache and Canaan then moved on or about September 4, 1975 to stay the action on the ground there was an agreement to arbitrate any disputes. Seymour submitted a memorandum of law in opposition to the defendants' motion.[6]

On January 14, 1976, the Hon. Charles H. Tenney denied the defendants' motion to stay the action on the ground that the agreement to arbitrate was not enforceable in light of the holding of United States Supreme Court in Wilko v. Swan, 346 US 427, 74 S.Ct. 182, 98 L.Ed. 168 (1953).

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5 17 C.F.R. §240.10b-5.

6 See docket entry of September 16, 1975.

POINT I

SEYMOUR DID NOT HAVE KNOWLEDGE OF HIS CLAIM OR OF THE EXISTENCE OF A CONTROVERSY WHEN HE SIGNED THE MARGIN AGREEMENTS AND THUS THIS ACTION SHOULD BE ALLOWED TO PROCEED

In Wilko v. Swan, supra, a stock purchaser brought suit against a brokerage house, charging violations of Section 12(2) of the 1933 Act. The plaintiff in Wilko had signed a margin agreement with a broadly worded arbitration clause. The court held that the arbitration clause was a condition and waiver within the meaning of Section 14 of the 1933 Act, which states that such conditions and waivers are void. Thus, the court held that the arbitration clause was unenforceable.

Bache contends that because Seymour signed the margin agreements with the arbitration clause after some of the disputed transactions took place, Wilko is not applicable. Appellant's brief, pp. 8-10.

This contention overlooks the nature of a churning scheme. While a victim of a churning scheme may be aware of the number of tr[illegible] in his account, the victim may not be aware that the trades are excessive under the circumstances. See Hect v. Harris Upham & Company, 283 FS. 417, 433 (N.D. Cal. 1968), modified on other grounds, 430 F 2d 1202 (9th Cir. 1970); see also Note, Churning by Securities Dealers, 80 Harv. L. Rev. 869 (1967). Further, the victim of the churning scheme may not be aware that the high number of trades was induced by a broker

anxious to earn even more commissions. See Hect v. Harris Upham & Co., supra at 433.[7]

Thus, the present case is clearly distinguishable from cases which have upheld an agreement to arbitrate when the plaintiff is aware of his claim but knowingly chooses to assert that claim in an arbitration forum. See, e.g., Moran v. Paine, Webber, Jackson & Curtis, 389 F 2d 242 (3rd Cir. 1968); Korn v. Franchard Corporation, 388 FSup. 1326 (SDNY 1975).

Bache does not assert that Seymour was aware of a possible claim against it when he signed the margin agreements. Cf. Wilko v. Swan, supra at 438, n.31 citing Brooklyn Savings Bank v. O'Neil, 324 US 697, 65 S.Ct. 895, 89 L.Ed. 1296 (1945). Any such assertion by Bache would be untenable since the complaint read as a whole denies that Seymour had such knowledge, and the allegations of the complaint must be deemed to be true.[8]

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[7] Several District Court cases in the Second Circuit have implicitly approved the concept of a churning action. See Newburger, Loeb & Co., Inc. v. Gross, 365 FSup. 1364, 1371 (SDNY 1973); Moscarelli v. Stamm, 288 FSup. 453, 457, 458 (EDNY 1968).

[8] See n.4, infra, and cases cited therein.

POINT II

THE DOCTRINE OF WILKO v. SWAN IS APPLICABLE TO VIOLATIONS OF THE 1934 ACT

Wilko arose under a suit alleging violations of Section 12 of the 1933 Act. Bache asserts that since the complaint alleges violations of the 1934 Act but not the 1933 Act, Wilko is not applicable to the present action. Appellant's Brief, pp. 12-14. Bache contends that the recent United States Supreme Court case of Scherk v. Alberto-Culver Co., 417 US 506, 94 S.Ct. 2449, 41 L.Ed. 2d 270 (1974) supports its position.

The cases decided before Scherk v. Alberto-Culver Co., supra, clearly hold that Wilko is applicable to violations of the 1934 Act. See Maheu v. Reynolds & Co., supra; Stockwell v. Reynolds & Co., 252 FS. 215 (SDNY 1965); Reader v. Hirsch & Co., 197 FS. 111 (SDNY 1961). Scherk does not change the impact of these cases.

Scherk is based on the ground that in an international business transaction between parties of similar bargaining strength, an arbitration provision will be enforced. Scherk v. Alberto-Culver Co., 417 US at 515, 516; see also Note -Arbitration Clauses in International Contracts and the Extra Territorial Reach of the Securities Exchange Act of 1934 in Light of Scherk v. Alberto-Culver Co., 26 Syracuse L.Rev. 995 (1975); Note - Arbitration and Securities Regulation - Conflict Between Federal Arbitration Act and Securities Exchange Act in an International Transaction, 40 Mo. L.Rev. 527, 534 (1975).

There is one reported case which deals with the impact of Scherk on Wilko. In Newman v. Shearson, Hammill & Co., Incorporated, 383 FSup. 265 (W.D. Tex. 1974), the court noted that Scherk did not overrule Wilko since Scherk is only applicable to international business transactions.

The 1934 Act contains a similar non-waiver provision as the 1933 Act. Compare §29(a) of the 1934 Act, 15 U.S.C. 78cc with §14 of the 1933 Act, 15 U.S.C. 77n. The court's holding in Wilko was grounded on this decision that the intention of Congress concerning the sale of securities is better carried out by holding arbitration agreements invalid. Wilko v. Swan, 417 US at 438. Certainly, Congress expressed similar concern with respect to claims under the 1934 Act. See, §29(a) of the 1934 Act, 15 U.S.C. 78cc(non-waiver provision); §10 of the 1934 Act, 15 U.S.C. 78j(fraud provision); §18 of the 1934 Act, 15 U.S.C. 78r(liability for misleading statements); §20 of the 1934 Act, 15 U.S.C. 78t(liabilities of controlling persons); §27 of the 1934 Act, 15 U.S.C. 78aa(exclusive jurisdiction provision).

CONCLUSION

The District Court's refusal to stay the action is correct and should be affirmed.

New York, New York
April 26, 1976

Respectfully submitted,

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Leon B. Lipkin
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Service of a copy of the within Brief is hereby admitted this 26th day of April, 1976

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Service of a copy of the within Brief is hereby admitted this 29th day of April, 1976

Paul R. Scott
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